The Manufacturers Hanover
Financial Digest
Economic Commentary, Selected Financial Data, and Business Indicators

MONDAY, NOVEMBER 24, 1986 VOLUME XXIII, NUMBER 25

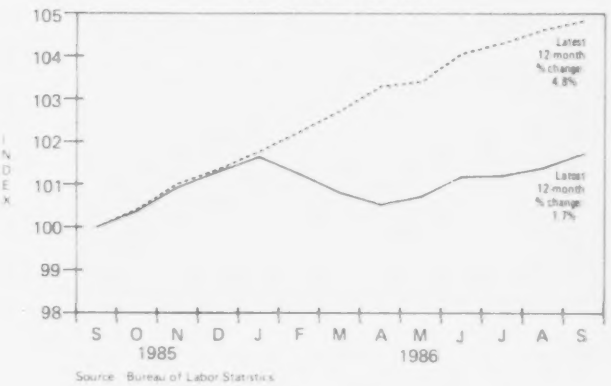
For The Time Being . . .

As the year draws to a close, one question overhanging the credit markets—other than the size of holiday bonuses and the future of high-yield corporate bonds—is how far into the new year will it be before the Federal Reserve eases monetary policy again. From this vantage point, the answer appears to be not too far. For although some signs point toward a pre-tax reform speed-up in business activity, and some of the best inflation rate news may be behind us, any market fears that monetary policy will be tightened are clearly premature. With highly visible soft spots dotted throughout the domestic and global economies, the Fed will continue to do all it can to keep today's business expansion on track—and that means maintaining an accommodative policy posture, and turning toward even more ease if economic growth falters in the new year.

Which raises the question as to whether or not growth will falter. In this regard, last week's upward revision to third-quarter, real gross national product growth offers few clues, since the GNP numbers are, by their very nature, backward-looking statistics. What is more, the onset of tax reform, in just over a month, is complicating the interpretation of the economic numbers. This is because both businesses and consumers have substantial incentives to spend sooner, rather than later—businesses to complete construction and accelerate capital equipment purchases before yearend to take advantage of today's more generous depreciation schedules, while consumers, by purchasing big-ticket items now, can take last-minute advantage of the deductibility of sales taxes. These incentives could do two things: They may at least partially explain the vigorous upturn in factory orders and construction spending toward the end of last quarter, and they could boost this quarter's growth at the expense of future quarters.

Nor does one have to look far to find pockets of persistent economic weakness. Industrial production remains soft, capacity utilization rates are still dropping and the trade balance deficit, although it may have stabilized, continues to hobble a sizable chunk of the manufacturing sector. Even the stimulus of consumer spending, one of the key factors behind the business expansion, may fade somewhat next year, given the sizable level of existing household debt, modest savings rates and the likelihood of more moderate employment growth. Add to this the fact that large chunks of idle capacity will continue to deter capital spending, and that commercial construction will be inhibited by lofty vacancy rates and the loss of tax benefits, and it appears to be a good bet that the economy might well hit an "air pocket" sometime in early 1987.

CONSUMER PRICE INDEX: TOTAL (LINE) VS. SERVICES (DOT)
<SEPTEMBER 1985=100>



Source: Bureau of Labor Statistics

. . . Monetary Policy . . .

But "air pocket" or not, the Fed apparently decided to put further monetary policy easing initiatives on hold at its November 5, policy-setting Federal Open Market Committee meeting. While some may question the approach of reacting to signs of future economic weakness, rather than trying to head them off in advance, behind this decision stands a combination of money supply, inflation rate and foreign exchange market considerations.

Take, for example, the money supply. Recent trends may be raising more than the usual number of yellow caution flags. Although the growth of the M1 money supply has been exceptionally rapid—and disregarded—all year long, the disturbing feature about recent developments is that the

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growth of the broader money supply numbers has accelerated as well. The year-to-date growth of the M2 money supply is now also above target, and the Fed's policymakers may feel that additional ease at this time would only compound the problem—and possibly damage the Fed's inflation-fighting credibility.

So, too, recent price trends may be raising considerable doubts as to whether or not inflation is as dormant as everyone seems to think it is. The Commodity Research Bureau's spot price index of raw industrial commodities, often a forerunner of broader inflation performance, has advanced by nearly 15 percent during the last 13 weeks, a sharp about-face when compared with the 3.4 percent drop in the index posted during the immediately preceding 13-week period. What is more, although consumer prices have risen by only 1.7 percent during the past year, the dramatic break in energy and food prices has tended to mask the ongoing rise of services prices—whose rate of rise in the past year is nearly three times that of the overall index. (See chart on page 1.)

. . . Is In A Holding Pattern

One further consideration is the recently-concluded accord between U.S. Treasury Secretary Baker and

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 11/19/86	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	201.587	+ 1.519	+21.789
Loans to Depository Inst.	1.103	+ .585	− .462
Float	1.480	+ .252	− .014
Total Reserve Bank Credit	220.717	+ 1.818	+24.249
Treasury Deposits with Federal Reserve Banks	3.696	− .034	+ .688
Currency in Circulation	205.566	+ .879	+14.008
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	164.518	− .136	+39.901
	11/19/86		
Member Bank Reserves:			
Total Reserves Held	54.279	+ 1.797	+ 9.205
Excess (Deficiency)	1.067	+ .250	+ .174
Net Free Reserves	.693	+ .299	+ .456

Monetary Aggregates†		% Change Since Three Months Ago*	% Change Since Year Ago
M1 (11/12/86)	712.8	+ 15.1‡	+ 14.6‡
M2 (October '86)	2,764.1	+ 9.6	+ 8.9
M3 (October '86)	3,443.5	+ 8.1	+ 8.3
Domestic Nonfinancial Debt (2nd Q'86)	7,181.0	+ 11.5	+ 13.1

†Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

Offering Rates 11/21/86	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	5.38%	5.41%	5.46%
* Federal Agencies	5.55	5.54	5.56
* Municipal Notes–High Grade (46% Taxable Equivalent)	6.48	7.22	7.78
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market–Prime	5.80	5.80	5.85

‡ Finance Company Paper–Prime

5- 14 days	5.60%
15- 29 days	5.60
30- 59 days	5.75
60- 89 days	5.75
90-179 days	5.67
180-239 days	5.70
240-270 days	5.70

‡* Bankers' Acceptances

Dec.	5.80%
Jan.	5.78
Feb.	5.65
Mar.	5.65
Apr.	5.60
May	5.58

‡ Industrial Paper–Prime

30- 89 days	5.83%
90-120 days	5.77

†Federal Funds Effective Rate 5.97%

‡ Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	3rd Q'86	$ 4,241r	$ 4,176	$ 4,031
Gross National Product (1982 Dollars)*	3rd Q'86	$ 3,687r	$ 3,661	$ 3,604
Percent Change, Annual Rate	3rd Q'86	2.9r	0.6	4.1
Change in Consumer Prices*	Sep '86	3.6%	2.4%	2.4%
Change in Producer Prices*	Oct '86n	3.6%	4.8%	12.0%
Civilian Employment (Thousands of Persons)†	Oct '86	110,240	109,891	107,813
Unemployment as % of Civilian Labor Force†	Oct '86	7.0%	7.0%	7.1%
Personal Income*	Oct '86n	$ 3,524	$ 3,512r	$ 3,358
Leading Indicators Composite Index (1967=100)†	Sep '86	180.1	179.3	170.6
Industrial Production Index (1977=100) †	Oct '86n	125.2	125.2r	123.6
Net Change in Consumer Installment Credit †	Sep '86	$ 8.37	$ 3.39	$ 10.33
U.S. Merchandise Trade Balance	Sep '86	−$ 12.56	−$ 14.03	−$ 11.68
Plant and Equipment Expenditures*	4th Q'86	$383.99(a)	$380.52(a)	$397.88
Private Housing Starts (Thousands of Units)*	Oct '86n	1,648	1,652r	1,784
New Construction Expenditures*	Sep '86	$ 385.7	$ 380.4	$ 361.3
Total Business Inventories †	Sep '86n	$ 588.4	$ 590.1r	$ 579.5
Total Business Sales †	Sep '86n	$ 441.6	$ 429.3r	$ 427.2r

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

Japanese Finance Minister Miyazawa. While it clearly hastened a turn toward more monetary ease in Japan, it may have the opposite effect here. Designed to achieve dollar-yen exchange rate stability, a Fed easing move now might undermine the U.S. pledge that it would no longer seek additional yen appreciation. Although a question mark exists as to whether or not an implicit dollar-yen exchange rate target was established, the common perception is that one was, and that it just happens to be at about present levels.

What renewed dollar depreciation would also do is dash expectations among Japanese institutional investors that this accord will diminish the exchange rate risk associated with acquiring dollar-denominated assets; it goes without saying that the likelihood of lower domestic interest rates would be significantly dimmed if these capital inflows tapered off to any great extent. As a result, while the primary concern of the central bank remains keeping the business expansion on track, and additional monetary ease and lower short-term interest rates would be a big help, a blend of money supply, inflation rate and foreign exchange market considerations are likely to keep monetary policy in a holding pattern for the time being.

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Time Deposits of $100,000 or more Weekly Reporting Banks			
Nationwide (11/5/86)	152,276	+ 228	– 5,330
New York City (11/12/86)	34,022	+ 171	+ 908
Commercial Paper (11/12/86)	330,809	+ 2,488	+42,467

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (11/5/86)	261,698	+ 4,327	+ 5,146
New York City (11/12/86)	60,837	+ 358	+ 937

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (11/5/86)	749,425	+ 5,273	+ 48,381
New York City (11/12/86)	165,355	+ 2,378	+ 12,684

Financial Markets

	Friday 11/21/86	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	5.48%	– .02	– 1.98
180-Day Bills†	5.58	– .07	– 2.10
Longest Bills†	5.73	– .07	– 2.08
Recent Issues:			
6 1/4s 11/31/88 (When Issued)	6.18	NA	
6 3/4s 9/30/90	6.56	– .13	
7 1/4s 11/15/96	7.16	– .11	
7 1/2s 11/15/16	7.44	– .09	
Municipals:			
Bond Buyer–20 Bond Index* (11/20/86)	6.78%	– .14	– 1.59
Blue List Total ($ Million)	$1,811	+$ 90	+ $183
30-Day Visible Supply ($ Million)	$4,159	+$1,379	– $727
Total	$5,970	+$1,469	– $544
Corporates:			
Moody's Aa Composite (11/20/86)	9.14%	– .11	– 1.80
30-Day Visible Supply ($ Million)	$2,710	–$1,402	+ $912
Stocks:			
Dow-Jones Averages:			
Industrials	1,893.56	+ 31.36	+ 432.78
Transportation	838.88	+ 4.63	+ 151.38
Utilities	211.48	+ 1.61	+ 45.60
65 Stocks	747.59	+ 9.03	+ 160.71
N.Y.S.E. Composite Index	140.94	+ .91	+ 24.70
N.Y.S.E. Avg. Daily Vol. for Week (000's)	172,460	+25,054	+ 47,464

* 46% Taxable equivalent 12.56%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 11/21/86	Week Ago
Overnight	5.88%	5.81%
1 month	6.00	5.94
3 month	6.00	5.94
6 month	5.94	5.94
1 year	6.00	6.06
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	7.21%	7.27%
Long Term (7 to 15 yrs.)	8.08	8.18

FOREIGN EXCHANGE SPOT RATES

New York Opening (11/21/86)	U.S. $ Equivalent	Currency Per U.S. $
Canada	.7212	1.3865
France	.1514	6.6070
Germany	.4956	2.0178
Italy	.0007157	1397.25
Japan	.006106	163.77
Mexico	.001179	848.00
Switzerland	.5940	1.6835
U.K.	1.4137	.7074

MH TRADE-WEIGHTED DOLLAR (11/19/86)	Change Since Week Ago	Change Since 2/27/86
	+ .2%	+ 1.2%

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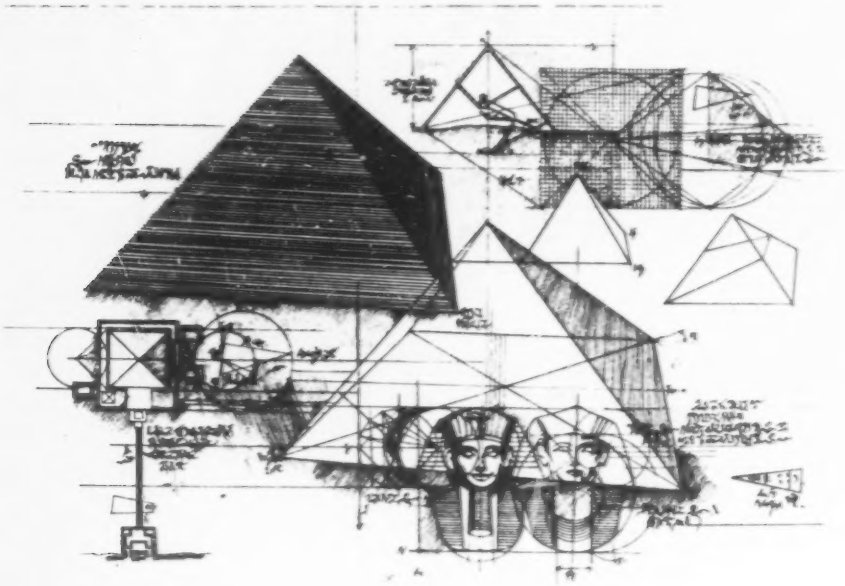

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